Supreme Court, U.S.
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No. _____

IN THE

Supreme Court of the United States

FREDERICK B. CAMPBELL,

Petitioner,

—v.—

UNITED STATES OF AMERICA,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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60 pp

Questions Presented

1. Whether federal income taxes on an individual's state and local income tax payments are unconstitutional because the money taken by the state is not income to the taxpayer for federal purposes.

2. Whether federal income taxes on an individual's state and local income tax payments violate intergovernmental tax immunity where:

(a) money received subject to other non-discretionary costs or obligations is not taxed, but money received under a non-discretionary obligation to be paid to the state is taxed; and/or

(b) money spent for personal medical care, interest on investments, and casualty and theft losses is not taxed, but money paid to the state for the same public purposes is taxed.

Table of Contents

Table of Authorities v

Opinions Below 1

Jurisdiction 2

Constitution and Statutes 2

Statement of the Case 2

Summary of the Argument 5

ARGUMENT 6

I. THE DECISION BELOW CONFLICTS WITH THIS COURT'S RULINGS ON LIMITS OF THE INCOME-TAX POWER . 6

A. The Federal Income-Tax Power Is Limited to Taxes on Actual Income . . . 7

B. Money Taken by State Income Taxes Is Not Income for Federal Purposes . . . 9

1. Not Gains or Accessions to Wealth 10

2. Not Complete Dominion 12

3. Not Clearly Realized 15

C. Discretionary Costs Are Not at Issue and the Money Is Not Profit 17

II. THE DECISION BELOW CONFLICTS WITH THIS COURT'S RULINGS ON GOVERNMENTAL TAX IMMUNITY 21

A. The Taxes Discriminate Against Persons Who Pay State and Local Income Taxes 22

B. The Taxes Discriminate Against State Medical Care, Investment and Losses 25

C. The Discrimination Is Not Justified 27

CONCLUSION 30

Appendix:

Summary Order, U.S. Court of Appeals for the Second Circuit (Sept. 6, 2002) A1

Memorandum and Order, U.S. District Court, S.D.N.Y. (Oct. 22, 2001) A6

United States Constitution (excerpts) A19

Internal Revenue Code, Section 68 (26 U.S.C. § 68) A20

Table of Authorities

Cases:	Page:
Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 75 S.Ct. 473, 99 L.Ed. 483 (1955)	7-8, 14, 16, 19
Commissioner v. Indianapolis Power & Light Co., 493 U.S. 203, 110 S.Ct. 589, 107 L.Ed.2d 591 (1990)	7-8, 10-11, 13-16, 19
Commissioner v. Kowalski, 434 U.S. 77, 98 S.Ct. 315, 54 L.Ed.2d 252 (1977)	8
Commissioner v. Tufts, 461 U.S. 300, 103 S.Ct. 1826, 75 L.Ed.2d 863 (1983)	10-11
Davis v. Michigan Dept. of Treasury, 489 U.S. 803, 109 S.Ct. 1500, 103 L.Ed.2d 891 (1989)	21-23, 25-26, 28-30
Eisner v. Macomber, 252 U.S. 189, 40 S.Ct. 189, 64 L.Ed. 521 (1920) . . .	7, 9, 17, 19
Fink v. State Tax Commission, 42 A.D.2d 298, 346 N.Y.S. 2d 611 (3d Dep't 1973)	11
Frick v. Pennsylvania, 268 U.S. 473, 45 S.Ct. 603, 69 L.Ed. 1058 (1925)	17
Goldin v. Baker, 809 F.2d 187 (2d Cir. 1987)	27-28

Grace v. New York State Tax Comm'n,
37 N.Y.2d 193, 332 N.E.2d 886,
371 N.Y.S.2d 715 (1975) 14

Gregory v. Ashcroft, 501 U.S. 452,
111 S.Ct. 2395, 115 L.Ed.2d 410 (1991) . . . 21, 27

Helvering v. Clifford, 309 U.S. 331,
60 S.Ct. 554, 84 L.Ed. 788 (1940) 8

Helvering v. Gerhardt, 304 U.S. 405,
58 S.Ct. 969, 82 L.Ed. 1427 (1938) 21, 23-25, 28

Helvering v. Horst, 311 U.S. 112,
61 S.Ct. 144, 85 L.Ed. 75 (1940) 15, 18

Hillsboro Nat. Bank v. C.I.R., 460 U.S. 370,
103 S.Ct. 1134, 75 L.Ed.2d 130 (1983) 15

Houston Industries Inc. and Subsidiaries
v. U.S., 125 F.3d 1442 (Fed. Cir. 1997) 10

Illinois Power Co. v. C.I.R.,
792 F.2d 683 (7th Cir. 1986) 11, 19

James v. United States, 366 U.S. 213,
81 S.Ct. 1052, 6 L.Ed.2d 246 (1961) 12

Jefferson County, Ala. v. Acker, 527 U.S.
423, 119 S.Ct. 2069, 144 L.Ed.2d 408 (1999). . 21

Knowlton v. Moore, 178 U.S. 41,
20 S.Ct. 747, 44 L.Ed. 969 (1900) 17

Max Sobel Wholesale Liquors v. C.I.R.,
630 F.2d 670 (9th Cir. 1980) 11, 20

New York v. United States, 505 U.S. 144, 112 S.Ct. 2408, 120 L.Ed.2d 120 (1992) 21

Phillips Chemical Co. v. Dumas Ind. Sch. Dist., 361 U.S. 376, 80 S.Ct. 474, 4 L.Ed.2d 384 (1960) 22, 25-26, 28-30

South Carolina v. Baker, 485 U.S. 505, 108 S.Ct. 1355, 99 L.Ed2d 592 (1988) 22, 25

Constitution of the United States:

Article I, Section 8, Clause 1 . . . . . 2, 9

Article I, Section 9 . . . . . 9, 15-16

Amendment X 2, 21

Amendment XVI 2

Statutes:

26 U.S.C. § 68 . . . . . 2-3, 25

26 U.S.C. § 86 28

26 U.S.C. § 164 2-3

26 U.S.C. § 275(a)(1) 20

28 U.S.C. § 1254 2

28 U.S.C. § 1331 4
28 U.S.C. § 1340 4
28 U.S.C. § 1346(a)(1) 4
N.Y. Tax Law § 601 2
N.Y. Tax Law § 612(b)(3)(A) 20
N.Y. Tax Law § 685(c) 2
N.Y. Tax Law §§ 692 13-14
N.Y. Tax Law § 1304 2
N.Y.C. Admin. Code § 11-1701 2

Other Authorities:

A. Hamilton, *The Federalist*, No. 32
(C. Rossiter ed. 1961) 24

Supreme Court of the United States

Frederick B. Campbell,

Petitioner,

-v.-

United States of America,

Respondent.

PETITION for WRIT of CERTIORARI

This is a petition for writ of certiorari to the United States Court of Appeals for the Second Circuit.

Opinions Below

The Second Circuit's opinion and order in this case, *Campbell v. United States*, is published at 2002 WL 31004727 and 2002 U.S. App. Lexis 18413 (2d Cir. No. 01-6270, Sept. 6, 2002). The District Court's opinion and order is published at 2001 WL 1262934 and 2001 U.S. Dist. Lexis 17063 (S.D.N.Y. No. 00 Civ. 4746, Oct. 22, 2001). The opinions respectively appear in the Appendix hereto at A1-A5 and A6-A18. They are not officially reported.

Jurisdiction

The Second Circuit's order was entered on September 6, 2002. This Court has jurisdiction to review the order by writ of certiorari under 28 U.S.C § 1254(1).

Constitution and Statutes

This petition involves the Internal Revenue Code's limitation on itemized deductions, 26 U.S.C. § 68, and Congress' power to tax income pursuant to Article I, Section 8, Clause 1 of, and the Sixteenth Amendment to, the United States Constitution. It also involves the reserved rights of the states and the people under the Tenth Amendment. These provisions are set out in the Appendix (at A19-A21).

Statement of the Case

Petitioner (hereafter "plaintiff") is an attorney who lives and works in New York City. In the years at issue, he was an unincorporated, solo practitioner. Like others working in the city, he was required to pay portions of his earnings to the state and city governments. Because he was self-employed, the state and local income taxes were not withheld. But he was required to pay quarterly estimated taxes, and he did so as required. (A6-A7); N.Y. Tax Law §§ 601, 685(c), 1304; Admin. Code of the City of New York § 11-1701.

Section 164 of the Internal Revenue Code allows

individuals to deduct their state and local income tax payments in calculating federal taxable income. 26 U.S.C. § 164. For those with income above a specified threshold, however, another code provision, Section 68, reduces the total of most itemized deductions by 3 percent of the taxpayer's adjusted gross income above the threshold. 26 U.S.C. § 68. The taxpayer's deductions for medical expenses, investment interest, and casualty and theft losses are not subject to the Section 68 limitation, but state and local income taxes are. *Id.*, § 68(c).

In 1996-1998, plaintiff's income was above the applicable threshold, and Section 68 limited his federal itemized deductions. Assuming that the limitation first applied to other relevant deductions, it prevented plaintiff from deducting more than $11,000 of his state and local income tax payments. Section 68 thus necessarily imposed federal taxes on at least that amount of plaintiff's state and local income tax payments in those years. Plaintiff paid those federal taxes and, in November 1999, applied for a refund. The Internal Revenue Service did not respond substantively. (A7).

Plaintiff commenced this action in June 2000, seeking refunds of the federal income taxes that were imposed on his state and local income tax payments. The complaint asserted, *inter alia*, that (1) sums that state and local governments take from an individual's receipts are not income to the taxpayer for federal purposes, and (2) the federal taxes

at issue also violate rights protected by the Tenth Amendment. (A3-A4).[1]

The District Court had jurisdiction under 28 U.S.C. §§ 1331, 1340 and 1346(a)(1). It held that the sums at issue are "profit" to the taxpayer because "[t]he money comes from clients who do not intend that the plaintiff return the money to them in the future." (A11-A12). It further held that the taxpayer has "complete dominion" over money owed to the state because he "is able to use that money immediately as his own." (A12). Consequently it held that the sums taken by the state are income to the taxpayer for federal purposes. *Id.* And it held that, "because Congress has the express power to tax income, the Tenth Amendment is not applicable." (A13). On October 22, 2001, it therefore dismissed the complaint for failure to state a claim on which relief may be granted. (A6).

On September 6, 2002, in a summary order that "may not be cited as precedential authority," the Second Circuit affirmed "for substantially the reasons set forth in the District Court's opinion." (A1, A5).

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[1] The complaint also asserted claims involving the current forms of the health-insurance exclusion, 26 U.S.C. §§ 106, 162(l), and the deduction for quailfied residence interest, 26 U.S.C. § 163(h). Those claims are not at issue here.

Summary of the Argument

When state and local governments withhold income taxes from an individual's earnings, the taxpayer does not realize the money in any way. For Congress to levy federal income taxes on such sums is as wrong as to do so on the proceeds of a loan or property sold at a loss. From the federal perspective, the funds are not gains or accessions to the taxpayer's wealth, so they are not income. And it is no different when the taxpayer is not subject to withholding, but instead pays quarterly estimated taxes. Such a taxpayer receives the money subject to a non-discretionary obligation to pay it to the state. He lacks "complete dominion" over the receipts, so they may not be subject to federal income taxes.

Moreover, the federal taxes at issue discriminate against persons dealing with state government. Funds received subject to other non-discretionary costs and obligations are excluded, but funds received under such obligations to the state are taxed. That penalizes workers in states that impose income taxes. And private expenditures for medical care and educational investment are not taxed, while payments to the state for the same public purposes are. Some states may decide that private funding of such services is preferable to public funding; others may decide the reverse. But the Constitution does not permit Congress to inhibit the latter state policy choice by imposing federal taxes that discriminate against individuals who pay state income taxes.

ARGUMENT

The Supreme Court should review the decision below because it conflicts with the Court's rulings on (1) the constitutional limits of the federal income-tax power and (2) the rights of states and persons dealing with them under the doctrine of intergovernmental tax immunity. The issues are respectively discussed in Points I and II below.

I. THE DECISION BELOW CONFLICTS WITH THIS COURT'S RULINGS ON LIMITS OF THE INCOME-TAX POWER

The purpose of an income tax is to distribute the financial burden of government according to the taxpayer's ability to pay. And income by definition is not the total amount of money that passes through one's hands, but rather the net amount obtained for personal use or disposal. Accordingly, as shown in Point I.A below, this Court has long held that the federal income-tax power is limited to impositions on the taxpayer's actual income, i.e., gains or accessions to wealth.

Moreover, as shown in Point I.B, this and other federal courts have repeatedly held that money received subject to a non-discretionary cost or obligation is not income to the extent of that cost or obligation. Money taken by state and local income taxes is received under such an obligation, and thus is beyond the scope of the federal income-tax power.

A. The Federal Income-Tax Power Is Limited to Taxes on Actual Income

For more than 80 years, this Court has consistently held that the federal income-tax power is limited to impositions on the taxpayer's actual income, i.e., realized gains or accessions to wealth. That unequivocal doctrine began with the 1920 decision of *Eisner v. Macomber*, 252 U.S. 189, 40 S.Ct. 189, 64 L.Ed. 521 (1920). It has continued through, most recently, the 1990 decision of *Commissioner v. Indianapolis Power & Light Co.*, 493 U. S. 203, 110 S. Ct. 589, 107 L.Ed.2d 591 (1990).

In *Eisner*, the Court held that federal income taxes could not be imposed on a stock split, because it was not "a gain, a profit, something of exchangeable value ..., and coming in, being 'derived,' that is, received or drawn by the recipient (the taxpayer) for his separate use, benefit, and disposal ...." *Eisner v. Macomber*, *supra*, 252 U. S. at 207, 40 S.Ct. at 193 (emphasis omitted).

In 1955, the Court discounted the significance of a statement in *Eisner* that income consists of gains "derived from capital, from labor, or from both combined." *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430-31, 75 S.Ct. 473, 476-77, 99 L.Ed. 483 (1955). But the latter decision confirmed *Eisner's* ruling that the income-tax power applies to taxes on actual income. As *Glenshaw* put it, income is "all gains" or "accessions to wealth, clearly realized, and over which the taxpayers have complete

dominion." *Id.*

And in 1990, the Court made clear that the *Glenshaw* rule continues to reflect limits of the income-tax power. *Commissioner v. Indianapolis Power & Light Co.*, *supra*. In that case, the Government asserted that a utility owed income taxes on security deposits received from customers. Citing the "accessions to wealth" formulation, however, the Court held that the deposits were not income, and could not be subject to federal income taxes, because the taxpayer did not have "complete dominion" over them. 493 U.S. at 209-10, 110 S.Ct. at 593.

Indianapolis Power & Light construed the statutory definition of "gross income." But this Court "has frequently stated that this language was used by Congress to exert in this field 'the full measure of its taxing power.'" *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429, 75 S.Ct. 473, 476, 99 L.Ed. 483 (1955). See also, e.g., *Commissioner v. Kowalski*, 434 U.S. 77, 82, 98 S.Ct. 315, 54 L.Ed.2d 252 (1977); *Helvering v. Clifford*, 309 U.S. 331, 334, 60 S.Ct. 554, 556, 84 L.Ed. 788 (1940).

In addition to setting the bounds of statutory gross income, the *Indianapolis Power & Light* decision therefore also reflects the same limit on Congress' income-tax power that the Court first recognized in the *Eisner* case: To be constitutionally valid, federal income taxes may only be imposed on the taxpayer's actual income, i.e., realized gains or accessions to wealth.

The income-tax power must be so limited, because otherwise there would be no limit to the federal tax power. If Congress could simply designate anything as "income" and tax it as such, the Apportionment and Uniformity clauses (Art. I, §§ 8, 9), and indeed all constitutional guarantees, would be meaningless.[2]

B. Money Taken by State Income Taxes Is Not Income for Federal Purposes

Sums that state and local governments take from an individual's receipts are not income to the taxpayer in any economic or rational sense. And as shown below, those sums do not have any of the characteristics of constitutionally taxable income that this Court has repeatedly identified. The sums at issue are (1) not gains or "accessions to wealth," (2) the taxpayer does not have "complete dominion" over them, and (3) they are not "clearly realized."

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[2] If the income-tax power were not limited to taxes on actual income, Congress might, for example, decree that ownership of property constitutes income, and tax it as such, thereby evading the Apportionment Clause. See *Eisner v. Macomber*, 252 U.S. 189, 207, 211-12, 217, 40 S.Ct. 189, 193, 194-95, 197, 64 L.Ed. 521 (1920). Or Congress could decree that residence in a particular group of states constitutes income, and tax it as such, thereby evading the Uniformity Clause. In effect, the taxes here at issue do just that (see pp. 22-27 below).

1. Not Gains or Accessions to Wealth

When a taxpayer obtains a loan, the obligation to repay the borrowed money offsets its receipt. The receipt of the loan is therefore not a gain or "accession to wealth," or income, to the taxpayer. As this Court held in *Commissioner v. Tufts*, 461 U.S. 300, 307, 103 S.Ct. 1826, 1831, 75 L.Ed.2d 863 (1983), "When a taxpayer receives a loan, he incurs an obligation to repay that loan at some future date. ***Because of this obligation***, the loan proceeds do not qualify as income to the taxpayer" (emphasis added).

A borrower's obligation to repay a loan is inherent in the receipt of the money, and therefore is ***non-discretionary***. (The borrower cannot obtain the funds without incurring the obligation.) And in other situations involving similarly non-discretionary costs or obligations, the obligated funds are likewise excluded from income. See, e.g., *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-10, 110 S.Ct. 589, 593, 107 L.Ed.2d 591 (1990) (customer security deposits are not income); *Houston Industries Inc. and Subsidiaries v. U.S.*, 125 F.3d 1442, 1444-46 (Fed. Cir. 1997) (customers' overpayments are not income).

The rule that such a non-discretionary cost or obligation prevents the obligated funds from being income is thus not limited to loans. Nor is it limited to situations where the taxpayer must return funds to the same person from whom he obtained them. See

Illinois Power Co. v. C.I.R., 792 F.2d 683, 689 (7th Cir. 1986) (surcharge required to be refunded to consumers different from those who paid it excluded from income of utility); *Max Sobel Wholesale Liquors v. C.I.R.*, 630 F.2d 670, 671-72 (9th Cir. 1980) (cost of goods sold excluded from income). (Costs of goods sold are non-discretionary because they are inherent in the transaction. One cannot obtain the proceeds without giving up the thing sold.)

Prior to the decision below, in fact, funds lawfully obtained subject to such a non-discretionary cost or obligation had always been held not to be income. That has to be the case, because a cost or obligation that the taxpayer inherently incurs by receipt of funds necessarily reduces his gain or "accession to wealth" to the extent of that cost or obligation. *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 207-10, 110 S.Ct. 589, 592-93, 107 L.Ed.2d 591 (1990); *Commissioner v. Tufts*, 461 U.S. 300, 307, 103 S.Ct. 1826, 1831, 75 L.Ed.2d 863 (1983).

And from the point of view of the Federal Government, the same is true of money that is taken by state and local income taxes. As soon as the taxpayer has a right to receive that money, the law imposes an obligation to pay it to the state. *Fink v. State Tax Commission*, 42 A.D. 2d 298, 300, 346 N.Y.S. 2d 611, 614 (3d Dep't 1973), *aff'd*, 34 N.Y.2d 898, 369 N.E.2d 718, 359 N.Y.S.2d 284 (1974). The money paid to the state therefore is not, and may not be

deemed to be, income to the taxpayer for federal purposes.[3]

2. Not Complete Dominion

The Court below acknowledged that money a taxpayer receives subject to loan obligations is not income. But based on the "complete dominion" factor, the Court attempted to distinguish obligations owed to the state and local governments: "[T]he recipient of a loan never has 'complete dominion' over the money unlike the recipient of business in-

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[3] The only exception to the rule that funds received under a non-discretionary cost or obligation are excluded from income involves crime. In embezzlement cases, for example, the law imposes an obligation to return the stolen funds. That money is nonetheless taxable as income to the embezzler. *James v. United States*, 366 U.S. 213, 218-19, 81 S.Ct. 1052, 1055, 6 L.Ed.2d 246 (1961). The reason for the exception, of course, is that one defying his legal obligations cannot claim that they prevent the contraband from being income. As this Court has put it, stolen funds are income because they are acquired "without the consensual recognition, express or implied, of an obligation to repay...." *Id.*, 366 U.S. at 219, 81 S.Ct. at 1055. That exception plainly does not apply in the present case, where both the taxpayer and the state at all times had a "consensual recognition" of his obligation to pay the taxes, and the taxpayer in fact paid them in each year at issue.

come [owed in estimated state income taxes] who is able to use that money immediately as his own." (A12).

The holding flies in the face of this Court's express ruling: "[S]imply because the [taxpayer] is free to use the funds in whatever fashion he chooses until the time of repayment" does not make such sums taxable as income. *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-10, 110 S.Ct. 589, 593, 107 L.Ed.2d 591 (1990).

And the holding directly conflicts with this Court's rule for determining whether a taxpayer has "complete dominion" over money he has received:

> ***In determining whether a taxpayer enjoys "complete dominion" over a given sum, the crucial point is not whether his use of the funds is unconstrained during some interim period. The key is whether the taxpayer has some guarantee that he will be allowed to keep the money.***

Id., 493 U. S. at 210, 110 S. Ct. at 593 (emphasis added).

There is only one conclusion when the rule is applied here. The taxpayer never has any "guarantee that he will be allowed to keep the money" owed in state and local income taxes. Indeed, the state's imposition of the tax guarantees that the taxpayer will ***not*** be allowed to keep the money. See N.Y. Tax

Law § 692 (providing for levy and attachment of tax liabilities).

In addition to the sums at issue not being "accessions to [the taxpayer's] wealth," the taxpayer thus lacks "complete dominion" over them. For this reason as well, the money in question is not part of the taxpayer's income for federal purposes, and it may not be subject to federal income taxes. *Commissioner v. Indianapolis Power & Light Co.*, *supra*, 493 U.S. at 210, 110 S.Ct. at 593; *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429-31, 75 S.Ct. 473, 476-77, 99 L.Ed. 483 (1955).[4]

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[4] *Indianapolis Power & Light* involved money paid to a utility as a security deposit. Such sums may become income to the recipient when and if the customer applies the deposit as payment for services. But since that is the customer's choice, the utility "acquires no unfettered 'dominion' over the money at the time of receipt." 493 U.S. at 212, 110 S.Ct. at 595. The same is true of portions of a taxpayer's receipts paid to state and local governments as income taxes. The state may allow the taxpayer to reduce the tax obligation, e.g. by allowing a deduction for donations to a charity approved by the legislature. If that occurs, however, it does so only if and to the extent that the legislature so decides. *Grace v. New York State Tax Comm'n*, 37 N.Y.2d 193, 196-97, 332 N.E.2d 886, 371 N.Y.S.2d 715, 718-19 (1975).

3. Not Clearly Realized

A taxpayer who has been required to pay estimated income taxes to a state may later get a refund of some of that money. A taxpayer may also receive personal benefits from the state. When and if such an event occurs, those accessions to the taxpayer's wealth may be subject to federal income taxes. *Hillsboro Nat. Bank v. C.I.R.*, 460 U.S. 370, 381-84, 103 S.Ct. 1134, 1142-43, 75 L.Ed.2d 130 (1983).

But the potential for a refund of estimated taxes, or the payment of state benefits, is not federally taxable unless and until the taxpayer actually receives those benefits, or has a right to receive them, because they are not previously realized. *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 211-12, 110 S.Ct. 589, 594-95, 107 L.Ed.2d 591 (1990) ("whether [a taxpayer's receipts] constitute income when received... depends upon the parties' rights and obligations *at the time the payments are made*"). See also *Helvering v. Horst*, 311 U. S. 112, 115-16, 61 S.Ct. 144, 146-47, 85 L.Ed. 75 (1940).[5]

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[5] In *Helvering v. Horst*, *supra*, the Court stated that the rule that income is not taxable until realized is "founded on administrative convenience." 311 U.S. at 116, 61 S.Ct. at 147. But the rule also has a constitutional element. If Congress purported to impose an "income" tax on an unrealized increase in market value of a taxpayer's residence, for example, the tax would likely violate the Apportionment Clause (Art.

The holding of the Court below -- that money taken from an individual's receipts by state and local governments is somehow purportedly income to the taxpayer for federal purposes -- thus conflicts with this Court's rulings in multiple ways. Sums taken by state and local income taxes are not "accessions to [the taxpayer's] wealth," the taxpayer never has "complete dominion" over such sums, and they are not "clearly realized." And if this Court's repeated rulings concerning "the full measure of [Congress' income] taxing power" have any meaning, the sums in question were not, and may not be deemed to be, income to the taxpayer for federal purposes. *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-10, 110 S.Ct. 589, 593, 107 L.Ed.2d 591 (1990); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430-31, 75 S.Ct. 473, 477, 99 L.Ed.

I, § 9). In reality it would be a non-apportioned direct tax on the property. See *Eisner v. Macomber*, 252 U.S. 189, 211-12, 217, 40 S.Ct. 189, 194-95, 197, 64 L.Ed. 521 (1920). Accordingly, this Court has repeatedly held that the "the full measure of [Congress' income] taxing power" is to tax "accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-10, 110 S.Ct. 589, 593, 107 L.Ed.2d 591 (1990); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 429-31, 75 S.Ct. 473, 476-77, 99 L.Ed. 483 (1955).

483 (1955); *Eisner v. Macomber*, 252 U.S. 189, 207, 211-12, 217, 40 S.Ct. 189, 193, 194-95, 197, 64 L.Ed. 521 (1920).[6]

C. Discretionary Costs Are Not at Issue and the Money Is Not Profit

The Court below stated that: "If the Court accepted plaintiff's perspective, all profits from businesses could not be taxed because they would have to be treated like loans." (A12). That is not at all the case.

First, plaintiff's claim encompasses only ***non-discretionary*** obligations such as that to pay the cost of goods sold, to return customers' security deposits or overpayments, and to pay state and local income

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[6] Federal estate taxes need not allow deductions for state estate taxes. See *Frick v. Pennsylvania*, 268 U.S. 473, 498-501, 45 S.Ct. 603, 608-09, 69 L.Ed. 1058 (1925); *Knowlton v. Moore*, 178 U.S. 41, 106-07, 20 S.Ct. 747, 778, 44 L.Ed. 969 (1900). An estate tax, however, is a transfer tax (like a sales tax or import duty) on the total amount of property that the decedent owns at death. *Id.*, 178 U.S. at 56-57, 20 S.Ct. at 753-54. See also *Frick*, *supra*, 268 U.S. at 498-99, 45 S.Ct. at 608. In contrast, an income tax by definition applies only to the recipient's net gain or accession to wealth. The rule for estate taxes therefore does not answer the questions at issue here.

taxes. (See pp. 10-12, *supra*.) Such obligations are few and far between. A business's advertising expenditures, for example, may be ordinary and necessary expenses that are deductible under the tax code, but they are discretionary. They are not inherent in the taxpayer's receipt of funds. Plaintiff's claim has no effect on the deductibility of such discretionary expenditures.[7]

Second, money received under a non-discretionary obligation to be paid to someone else is in any event not profit, of a business or otherwise. The Court below held that sums taken by state and local income taxes are profit, because "the money comes

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[7] Nor does plaintiff's claim have any effect on the rule that an "anticipatory assignment" does not prevent the assigned receipts from being income. See, e.g., *Helvering v. Horst*, 311 U.S. 112, 120, 61 S.Ct. 144, 149, 85 L.Ed. 75 (1940). If such an assignment creates an obligation to transfer a portion of one's receipts to someone else, it is voluntarily incurred, not inherent in the receipt or non-discretionary. For the same reason, there is no constitutional requirement that federal income taxes exclude money paid in state property or sales taxes. The taxpayer's obligation to pay those impositions depends upon his choice to own the property or purchase the goods to which the tax applies. Such costs are not non-discretionary obligations arising by virtue of the taxpayer's receipt of the money.

from clients who do not intend that the plaintiff return it to them in the future." (A11-A12). But that ruling is fundamentally wrong.

Under this Court's repeated rulings, the issue is not whether a taxpayer must return money to the person from whom it came. Rather it is whether the receipt is some form of gain or "accession to wealth" for the taxpayer. *Commissioner v. Indianapolis Power & Light Co.*, 493 U.S. 203, 209-10, 110 S.Ct. 589, 593, 107 L.Ed.2d 591 (1990); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430-31, 75 S.Ct. 473, 477, 99 L.Ed. 483 (1955); *Eisner v. Macomber*, 252 U. S. 189, 207, 211-12, 217, 40 S.Ct. 189, 193, 194-95, 197, 64 L.Ed. 521 (1920).

And an obligation that the taxpayer necessarily incurs by receipt of funds reduces the taxpayer's actual gain or accession to wealth (or profit) in the same amount regardless of whether the obligation is to the person who paid the money or to someone else. See *Illinois Power Co. v. C.I.R.*, 792 F.2d 683, 689 (7th Cir. 1986) ("we cannot see what difference it makes that the [taxpayer's obligations to pay] refunds here were to a class of customers some or many members of which may have been different individuals from those who paid" the money to the taxpayer).

Finally, it is not true that whatever is profit or income for state purposes must also be profit or income for federal purposes. When any particular jurisdiction asks how much profit or income an

individual has, for purposes of imposing a tax on that sum, the effect of the tax for purposes of which the question is being asked is not considered. That is elementary logic, and it is reflected in both state and federal law. See N.Y. Tax Law § 612(b)(3)(A); 26 U.S.C. § 275(a)(1). But that does not mean that the effect of obligations owed to a different jurisdiction can be ignored.

From the point of view of the Federal Government, money that an individual receives subject to a non-discretionary obligation to be paid to the state and local governments is no more part of the taxpayer's gain or profit or accession to wealth than money he receives subject to other such obligations. None are part of the taxpayer's actual income for federal purposes, and none may be constitutionally subjected to federal income taxes. (See pp. 7-16, *supra*.)[8]

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[8] The Court below did not rely on the "claim of right" doctrine, with good reason. That rule does not apply where, as here, the taxpayer incurs a non-discretionary cost or obligation as a result of receipt of funds, so that his actual gain or accession to wealth is necessarily reduced by the amount of the cost or obligation. See *Max Sobel Wholesale Liquors v. C.I.R.*, 630 F.2d 670, 671-72 (9th Cir. 1980) and cases cited therein (costs of goods sold are excluded from income, notwithstanding that sales receipts are obtained under claim of right).

II. THE DECISION BELOW CONFLICTS WITH THIS COURT'S RULINGS ON GOVERNMENTAL TAX IMMUNITY

This Court has long recognized that the American federal system requires that state governments be "free of inhibition by the national taxing power, of 'the high and responsible duties assigned to them in the Constitution.'" *Helvering v. Gerhardt*, 304 U.S. 405, 414-15, 58 S.Ct. 969, 973, 82 L.Ed. 1427 (1938) (citations omitted). That intergovernmental tax immunity bars federal "taxes that are imposed directly on [the state] sovereign... or that discriminate against a [state] sovereign or those with whom it deals." *Jefferson County, Ala. v. Acker*, 527 U.S. 423, 437, 119 S.Ct. 2069, 2077, 144 L.Ed.2d 408 (1999); *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 811, 109 S.Ct. 1500, 1505, 103 L.Ed.2d 891 (1989).[9]

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[9] To the extent that the doctrine of intergovernmental tax immunity protects state governments from federal taxes, it is based on their "sovereign and reserved rights." *Helvering v. Gerhardt*, *supra*, 304 U.S. at 414-15, 58 S.Ct. at 972-73. Those "reserved rights" are among the rights protected by the Tenth Amendment. See, e.g., *Gregory v. Ashcroft*, 501 U.S. 452, 457-58, 111 S.Ct. 2395, 2399, 115 L.Ed.2d 410 (1991); *New York v. United States*, 505 U.S. 144, 155-59, 112 S.Ct. 2408, 2417-19, 120 L.Ed.2d 120 (1992).

Here there is no question of a federal tax being imposed directly on a state sovereign. See *South Carolina v. Baker*, 485 U.S. 505, 523 n.14, 108 S.Ct. 1355, 1367, 99 L.Ed.2d 592 (1988). But the taxes at issue discriminate against states and persons dealing with them in several ways. Each renders the taxes unconstitutional.

A. The Taxes Discriminate Against Persons Who Pay State and Local Income Taxes

As discussed in Point I above, money received under a non-discretionary obligation to be paid to someone else is not subject to federal income taxes, with one exception. Funds received under an involuntary obligation to be paid to the state and local governments are federally taxed. (See pp. 10-12, *supra*.) Even if the Constitution did not require that funds received subject to non-discretionary costs or obligations always be excluded from federal income taxes, it still would bar the Federal Government from singling out such obligations owed to the state. See, e.g., *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 479, 4 L.Ed.2d 384 (1960) (one jurisdiction "may not single out those who deal with [the other]... for a tax burden not imposed on others similarly situated"); *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 811, 109 S.Ct. 1500, 1505, 103 L.Ed.2d 891 (1989).

That is especially so, where, as here, the discrimination has invidious effects. Consider two hypo-

thetical families:

The Bakers have $50,000 of salary and work in a state that does not impose income taxes. The Clarks have $55,000 of salary and work in a state takes $5,000 from their receipts. Both families have the same amount of earnings available to pay a federal tax and for all discretionary expenditures ($50,000). But if Congress imposes a 20% tax without deduction of the state tax, the Clarks must pay more than the Bakers. Because the federal tax applies to the money taken by the state, the Clarks must pay $11,000, while the Bakers pay only $10,000. And after payment of the federal and state taxes, the Bakers are left with $40,000 for discretionary expenses, while the Clarks have only $39,000.

Such federal penalties on persons who choose to work or reside in states that impose income taxes undermine the purpose of intergovernmental tax immunity. The doctrine "is based on the need to protect each sovereign's governmental operations from undue interference by the other." *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803, 814, 109 S.Ct. 1500, 1507, 103 L.Ed.2d 891 (1989). See also *Helvering v. Gerhardt*, 304 U.S. 405, 414-15, 58 S.Ct. 969, 972-73, 82 L.Ed. 1427 (1938). And federal taxes that so penalize states for imposing income taxes are surely "undue interference."

If the Federal Government could tax workers and residents in one state more heavily than those in another, based on the state's choice of whether to

impose income taxes, states would not be "free of inhibition by the national taxing power, of 'the high and responsible duties assigned to them in the Constitution.'" *Helvering v. Gerhardt*, 304 U.S. 405, 414-15, 58 S.Ct. 969, 973, 82 L.Ed. 1427 (1938). Rather, they would eventually have little choice but to reduce or eliminate income taxes and the public services they fund.

And such federal inhibition of the state government's fiscal choices is contrary to the plain intention of the Constitution's drafters. The Constitution gives Congress power to approve or disapprove state taxes on imports or exports (Art. I § 10). As Alexander Hamilton explained in 1788, the express restriction "implies an admission that if it were not inserted the States would possess the power it excludes; and it implies a further admission that as to all other taxes, the authority of the States remains undiminished." *The Federalist* No. 32 (C. Rossiter ed. 1961) at 199. Except for duties on imports and exports, the drafters thus intended that "the individual States should possess an independent and uncontrollable authority to raise their own revenues for the supply of their own wants." *Id.* at 197-98.

If the new Constitution had allowed Congress to levy heavier federal taxes on workers and residents in states that choose to impose their own income taxes, the taxing authority of states would not have been "undiminished." Nor would states have had "an independent and uncontrollable authority to

raise their own revenues for the supply of their own wants." In addition to violating constitutional limits of the federal income-tax power, the challenged application of Section 68 thus also violates rights reserved to the states and their residents under the Tenth Amendment. *Davis v. Michigan Dept. of Treasury*, 489 U.S.803, 811, 109 S.Ct. 1500, 1505, 103 L.Ed.2d 891 (1989); *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 479, 4 L.Ed.2d 384 (1960).[10]

B. The Taxes Discriminate Against State Medical Care, Investment and Losses

Among other types of discrimination, intergovernmental tax immunity bars federal taxes that treat persons who deal with state government less favorably than those who deal with the private sector. See *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 381, 80 S.Ct. 474, 478, 4 L.Ed.2d 384 (1960) ("discrimination between the Government's lessees and lessees of private property" would be unconstitutional); *Helvering v. Gerhardt*, 304 U.S. 405, 420, 58 S.Ct. 969, 975, 82 L.Ed. 1427 (1938)

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[10] The *Davis* and *Phillips* cases involved discrimination against persons dealing with the Federal Government. But the rule for immunity of states from federal taxes is "essentially the same" as the rule for immunity of the Federal Government from state taxes. *South Carolina v. Baker*, 485 U.S. 505, 523, 108 S.Ct. 1355, 1367, 99 L.Ed.2d 592 (1988).

(federal tax on state employees must be a "nondiscriminatory tax laid on their net income, in common with that of all other members of the community"). The taxes at issue violate this rule on their face.

The taxpayer's expenditures for medical care, investment interest, and casualty and theft losses are expressly excluded from the Section 68 limitation. 26 U.S.C. § 68(c). State income taxes of course support similar public expenditures: the state's expenses for Medicaid and other public medical care, the state's payment of interest on funds used for public investment, and state assistance to victims of casualties and theft, as well as such costs and losses of the state government itself. But the taxpayer's payments to state and local government for these purposes are not exempted from Section 68's limitation.

Some states may decide that private individuals should pay for their own medical care, or invest to pay for their own education. Others may decide that the government should use income taxes to make medical care and college available to all. Some in Congress no doubt have opinions about which state policy is better. But the Constitution does not permit Congress to penalize the latter policy choice by discriminatorily taxing state as opposed to private funding of such needs. See *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 479, 4 L.Ed.2d 384 (1960); *Davis v. Michigan Dept. of Treasury*, 489 U.S.803, 811, 109

S.Ct. 1500, 1505, 103 L.Ed.2d 891 (1989); *Gregory v. Ashcroft*, 501 U.S. 452, 457-58, 111 S.Ct. 2395, 2399, 115 L.Ed.2d 410 (1991).

Even if the Constitution did not require that sums received under non-discretionary obligation to be paid to someone else be excluded from federal income taxes, therefore, the taxes at issue still would be unconstitutional. The Constitution does not permit Congress to single out such obligations owed to the state government when other non-discretionary costs and obligations are not federally taxed. And it does not permit federal taxes to discriminate against state medical care, investment and losses.

C. The Discrimination Is Not Justified

The Government has not at any stage of this action asserted any purported justification for Section 68's discrimination against states and persons who deal with them, and the Court below offered none. Instead, the Court held that "because Congress has the express power to tax income, the Tenth Amendment is not applicable here," citing *Goldin v. Baker*, 809 F.2d 187, 191 (2d Cir. 1987), *cert. denied*, 484 U.S. 816, 108 S.Ct. 69, 98 L.Ed.2d 32 (1997). (A13).

The ruling is incorrect for two reasons. First, as shown in Point I above, the taxes here are beyond the scope of the federal income-tax power. And second, even if that were not so, it still would be unconstitutional for federal taxes to discriminate

against states and persons who deal with them. *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 479, 4 L.Ed. 2d 384 (1960); *Helvering v. Gerhardt*, 304 U.S. 405, 420, 58 S.Ct. 969, 975, 82 L.Ed. 1427 (1938).[11]

The doctrine of intergovernmental tax immunity always applies to taxes that would be constitutional if they were not imposed on the sovereign, or did not discriminate against the sovereign or persons dealing with it. *Davis v. Michigan Dept. of Treasury*, 489 U.S.803, 815-17, 109 S.Ct. 1500, 1508-09,

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[11] The reliance of the Court below on *Goldin v. Baker*, 809 F.2d 187, 191 (2d Cir. 1987), *cert. denied*, 484 U.S. 816, 108 S.Ct. 69, 98 L.Ed.2d 32 (1987) (A13), is misplaced. *Goldin* involved 26 U.S.C. § 86, which imposes federal income taxes on Social Security benefits of retirees whose income exceeds a specified level. Municipal bond interest is included in determining whether the taxpayer has the threshold amount of income. The Court held that inclusion did not violate intergovernmental tax immunity. But under Section 86, interest on state-issued bonds is not treated less favorably than interest on privately issued bonds. Nor did *Goldin* involve any other discrimination against the state or persons dealing with it. In the present case, in contrast, the federal tax treats obligations owed to the state government less favorably than those owed to private entities, and otherwise discriminates against persons dealing with the state, as discussed above.

103 L.Ed.2d 891 (1989). In the latter case, for example, there was no question about the authority of the state to impose income taxes on retirement benefits of federal employees. The only issue was whether the state could do so while the benefits of state employees were exempted. And although the Constitution plainly allows states to levy income taxes, this Court found the discrimination unconstitutional. See also, e.g., *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 479, 4 L.Ed.2d 384 (1960).

Where an otherwise constitutionally valid federal tax discriminates against a state or persons dealing with it, the discrimination is unconstitutional unless "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Davis v. Michigan Dept. of Treasury*, 489 U.S.803, 816, 109 S.Ct. 1500, 1508, 103 L.Ed.2d 891 (1989); quoting *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U. S. 376, 383-85, 80 S.Ct. 474, 479-80, 4 L.Ed.2d 384 (1960).

Here there is no conceivable justification for the discriminatory tax treatment, much less any justification "directly related to... significant differences between the two classes." A taxpayer's obligation to pay state and local income taxes is, if anything, more binding, and less discretionary, than his obligation to pay other non-discretionary costs that are excluded from federal taxes, such as costs of goods sold. Citizens who live or work in states that

impose income taxes are not thereby deserving of heavier federal impositions. And money paid to the state for public medical care, interest on public investments, and public casualty and theft losses is not less of a cost to the taxpayer than money he spends for the same private purposes.

Even if money that state and local governments take from an individual's receipts could be deemed to be income to the taxpayer for federal purposes, the taxes at issue therefore still would be, and are, unconstitutional. *Davis v. Michigan Dept. of Treasury*, 489 U.S.803, 815-17, 109 S.Ct. 1500, 1508-09, 103 L.Ed.2d 891 (1989); *Phillips Chemical Co. v. Dumas Ind. Sch. Dist.*, 361 U.S. 376, 383, 80 S.Ct. 474, 479, 4 L.Ed.2d 384 (1960).

CONCLUSION

The Supreme Court should grant certiorari.

Respectfully submitted,

Frederick B. Campbell

555 Fifth Avenue, Suite 1700
New York, New York 10017
(212) 378-1720

Dated: October 24, 2002

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

[Stamped:] FILED SEP 6 2002,
Roseann B. MacKechnie, Clerk,
United States Court of Appeals,
Second Circuit

THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND MAY NOT BE CITED AS PRECEDENTIAL AUTHORITY TO THIS OR ANY OTHER COURT, BUT MAY BE CALLED TO THE ATTENTION OF THIS OR ANY OTHER COURT IN A SUBSEQUENT STAGE OF THIS CASE, IN A RELATED CASE, OR IN ANY CASE FOR PURPOSES OF COLLATERAL ESTOPPEL OR RES JUDICATA.

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 6th day of SEP Two thousand and Two.

PRESENT:

HON. RICHARD J. CARDAMONE,
HON. CHESTER J. STRAUB,
HON. ROBERT A. KATZMANN,
Circuit Judges.

FREDERICK B. CAMPBELL,

Plaintiff-Appellant,

- v. -

UNITED STATES OF AMERICA,

Defendant-Appellee.

SUMMARY ORDER
No. 01-6270

Appearing for Appellant:	Frederick B. Campbell, *pro se*, New York, NY
Appearing for Appellee:	Elizabeth Wolstein and Gideon A. Schor, Assistant United States Attorneys, New York, NY (James B. Comey, United States Attorney for the Southern District of New York), *for the United States of America*.

Appeal from the United States District Court for the Southern District of New York (Lawrence M. McKenna, *Judge*).

AFTER ARGUMENT AND UPON DUE CONSIDERATION, [I]T IS HEREBY ORDERED, ADJUDGED AND DECREED that the judgment of the District Court is hereby AFFIRMED.

Plaintiff-Appellant Frederick B. Campbell, *pro se*, appeals from an order of the United States District Court for the Southern District of New York (Lawrence M. McKenna, *Judge*), denying his motion for partial summary judgment and granting appellee's motion to dismiss his complaint seeking a tax refund. We assume familiarity with the factual background and procedural history set forth in the opinion of the District Court, *Campbell v. United States*, No. 00 Civ. 4746, 2001 WL 1262934 (S.D.N.Y. Oct. 22, 2001).

Plaintiff filed a timely notice of appeal and subsequently submitted an appellate brief, largely restating the arguments he previously advanced in challenging the constitutionality of three provisions of the Internal Revenue Code ("IRC") and seeking a refund of federal income taxes. Specifically, he argued that: (1) the federal income taxes on amounts taken as state and local income taxes pursuant to 26 U.S.C. § 68 was beyond the authority granted to

Congress by the Sixteenth Amendment, and infringed on the reserved rights of the States in violation of the Tenth Amendment; and (2) the current forms of the health insurance tax exclusion and residential mortgage interest deduction, 26 U.S.C. §§ 106, 162(l) and 163(h), were unlawful delegations of Congress' taxing power to private entities outside the Government, and that the exclusions should apply equally regardless of whether the individual is self-employed or has obtained a mortgage. Plaintiff further sought leave to amend his complaint to seek injunctive relief.

This Court reviews a district court's application of law with regard to its denial of a motion for partial summary judgment, as well as its grant of a motion to dismiss, de novo.* See S.E.C. v. Credit

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* Ordinarily, an order that denies summary judgment or grants partial summary judgment cannot by itself be the basis for appeal, as it is nonfinal. However, upon entry of final judgment, earlier, nonfinal orders that affect judgment become subject to appellate review. See United States v. 228 Acres of Land and Dwelling Located on Whites Hill Road in Chester, Vt., 916, F.2d 808, 811 (2d Cir. 1990). The District Court's order denying partial summary judgment is clearly nonfinal; however, the District Court also granted the Government's motion to dismiss, rendering the order final and reviewable, in its entirety, on this appeal.

Bancorp, Ltd., 290 F.3d 80, 87 (2d Cir. 2002); Sweet v. Sheahan, 235 F.3d 80, 83 (2d Cir. 2000). Having considered all of plaintiff's contentions on appeal, we affirm both the denial of his motion for partial summary judgment and the grant of the government's motion to dismiss for substantially the reasons set forth in the District Court's opinion.

Plaintiff's request to amend his complaint to seek injunctive relief is denied since appellant failed to raise this request in the District Court before the appellee filed its motion to dismiss, and appellant cannot do so for the first time on appeal. See Dwares v.City of New York, 985 F.2d 94, 101 (2d Cir. 1993) (leave to amend denied because plaintiff made no effort to exercise his right to amend under Fed. R. Civ. P. 15(a) before defendant filed motion to dismiss in lieu of answer and where plaintiff raises request to amend for the first time on appeal).

Accordingly, the judgment of the District Court is AFFIRMED.

FOR THE COURT:
ROSEANN B. MACKECHNIE, CLERK

s/Lucille Carr 9/6/02

BY: DATE:

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

FREDERICK B. CAMPBELL,	:	[Filed: Oct. 22,
	:	2001, U.S.D.C.,
Plaintiff,	:	S.D.N.Y.]
	:	
- against -	:	00 Civ. 4746
	:	(LMM)
UNITED STATES	:	
of AMERICA,	:	MEMORANDUM
	:	AND ORDER
Defendants.	:	

McKENNA, D.J.

Frederick Campbell ("plaintiff") commenced this action against the United States of America ("defendant" or "the government") claiming that three provisions of the Internal Revenue Code ("tax code") provide for unconstitutional limitations on deductions. As a result of these limitations, plaintiff seeks tax refunds for taxes paid in 1996, 1997, and 1998. Presently before the Court are plaintiff's motion for partial summary judgment under Federal Rule of Civil Procedure 56 and the government's motion to dismiss under Federal Rule of Civil procedure 12(b)(6). For the reasons set forth below, plaintiff's motion is denied and defendant's motion is granted.

Background

Plaintiff has worked in New York City as a self-employed attorney and freelance writer since 1995. Plaintiff pays income taxes to New York City, New York State, and the federal government. Because plaintiff's adjusted gross income is above a certain amount, the tax code limits the amount plaintiff can deduct from his federal taxes to compensate for the local and state taxes he pays. 26 U.S.C. § 68. Moreover, because plaintiff is self-employed and provides for his own health insurance, the tax code allows him to only partially deduct his health insurance costs. 26 U.S.C. § 162(l). Finally, when plaintiff purchased his apartment in 1994, he paid for the home in full and did not take out a mortgage. Thus, he is not eligible for a residence deduction on interest payments for acquiring a home as set forth in 26 U.S.C. § 163(h). Plaintiff claims such limitations unconstitutional and, therefore, that he overpaid on his federal income taxes for the years 1996-1998. Thus, plaintiff seeks a refund of $9,702.77 plus interest for 1996, $9,325.00 plus interest for 1997, and $8,445.65 plus interest for 1997.

Plaintiff moved for partial summary judgment for a determination on the constitutionality of the provisions set forth above. The government opposed plaintiff's motion and also brought a motion to dismiss plaintiff's complaint. The Court

will discuss each provision separately in its discussion below.

Discussion

I. Legal Standards

A. Summary Judgment

Summary judgment should be granted only "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." Fed. R. Civ. P. 56(c); Celotex Corp. v. Catrett, 477 U.S. 317, 322 (1986). A dispute regarding a material fact is genuine "if the evidence is such that a reasonable jury could return a verdict for the nonmoving party." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248 (1986).

Once the moving party establishes a prima facie case demonstrating the absence of a genuine issue of material fact, the nonmoving party has the burden of presenting "specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). The nonmoving party must "do more than simply show that there is some metaphysical doubt as to the material facts," Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986), and "may not rely on conclusory allegations or unsubstantiated speculation." Scotto v. Alemenas, 143 F.3d 105, 114 (2d Cir. 1988). "If, as to the

issue on which summary judgment is sought, there is any evidence in the record from any source from which a reasonable inference could be drawn in favor of the nonmoving party, summary judgment is improper." Chambers v. TRM Copy Ctrs. Corp., 43 F.3d 29, 37 (2d Cir. 1994).

B. Motion to Dismiss

Under Rule 12(b)(6), a complaint will be dismissed if there is a "failure to state a claim upon which relief can be granted." Fed. R. Civ. P. 12(b)(6). The Court must read the complaint generously accepting the truth of and drawing all reasonable inferences from well-pleaded factual allegations. See Mills v. Polar Molecular Corp., 12 F.3d 1170, 1174 (2d Cir. 1993). "A court should only dismiss a suit under Rule 12(b)(6) if 'it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief.'" Valmonte v. Bane, 18 F.3d 992, 998 (2d Cir. 1994) (quoting Conley v. Gibson, 355 U.S. 41, 45-46 (1957)).

II. 26 U.S.C. § 68

Plaintiff claims that 26 U.S.C. § 68 of the tax code, which allow taxpayers to deduct "some, but not all, of the amounts that the State and City of New York take from Plaintiff's earnings," (Wolstein Aff. Ex. A ¶ 9.), violates the Sixteenth Amendment, the Tenth Amendment and sections 2, 8, and 9 of

Article I of the United States Constitution. (Wolstein Aff. Ex. A ¶¶ 10-15.) Defendant, on the other hand, argues that 26 U.S.C. § 68 is valid and constitutional in all respects. The Court agrees with the defendant.

Congress' power to impose a federal income tax is stated in the Sixteenth Amendment: "[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI. The tax code imposes such a tax on income and defines gross income as "all income from whatever source derived." 26 U.S.C. § 61. The Supreme Court has subsequently clarified that gross income includes all "undeniable accessions to wealth, clearly realized, and over which the taxpayers have complete dominion." Commissioner v. Glenshaw Glass Co., 348 U.S. 426, 431 (1955).

Thus, not every form of gain for a taxpayer is taxable income. For example, because a taxpayer has the obligation to repay money received as a loan, a loan is not considered gross income. Collins v. Commissioner, 3 F.3d 625, 630 (2d Cir. 1993); see also Commissioner v. Indianapolis Power & Light Co., 493 U.S. 203, 214 (1990) (customer deposits to electric company, which ensure future payment of electric bills but are returned to customer upon satisfying a credit test, are not

income subject to federal income tax upon receipt). The key to determine whether something received by the taxpayer is taxable income "is whether the taxpayer has some guarantee that he will be allowed to keep the money." Indianapolis Power & Light Co., 493 U.S. at 210 (1990).

Plaintiff argues that the taxes he must pay to state and local governments cannot be considered income for the purposes of federal income taxation because such money is not income, but rather, "revenue," which he has an obligation to pay to the state and local governments. As such, plaintiff argues, the money must be treated like a loan for tax purposes. (Pl.'s Mem. of Law in Support of Mot. for Partial S.J. at 4.) The government, on the other hand, contends that plaintiff's earnings from his businesses, regardless of what he pays to the state and city, are taxable income. (Def.'s Mem. of Law in Support of Mot. to Dismiss and in Opp. to Pl.'s Mot. for Partial S.J. at 11.) The government thus maintains that the limitation on the deduction for high income taxpayers is constitutional because the amount that cannot be deducted is merely a tax on income.

Plaintiff's contention that the revenues he pays to state and city government in taxes should be treated like a loan is meritless. First, unlike a loan, the revenue at issue is profit generated from his private business as an attorney and freelance writer. The money comes from clients who do not intend that

the plaintiff return the money to them in the future. Second, plaintiff's claim that such money cannot be considered an "accession to wealth" because he has an obligation to repay it to the government fails to recognize that his profits cannot be characterized as a loan because the state and local governments are not lending the money to him in the first instance. The Second Circuit has stated that, "loans are identified by the mutual understanding between the borrower and lender of the obligation to repay and a bona fide intent on the borrower's part to repay the acquired funds." Collins, 3 F.3d at 631. Thus, the fundamental idea of a loan is that one party lends money to another party with the expectation that it will be paid back. The money paid to the state and local government was not a loan.

Finally, the recipient of a loan never has "complete dominion" over the money unlike the recipient of business income who is able to use that money immediately as his own. The fact that plaintiff owes taxes to state and local governments does not change the fact that the money he received was business income. If the Court accepted plaintiff's perspective, all profits from businesses could not be taxed because they would have to be treated like loans. Thus, the Court finds that tax code provision 26 U.S.C. § 68 does not violate the Sixteenth Amendment. In addition, because the tax is one on income and not a direct tax, it does not violate Article I, Sections 2 and 9 of the Constitution.

Further, the limitation in 26 U.S.C. § 68 does not violate the Tenth Amendment, as plaintiff asserts, because the Tenth Amendment reserves to the states powers not delegated to the federal government. U.S. Const. amend. X. Thus, because Congress has the express power to tax income, the Tenth Amendment is not applicable here. Goldin v. Baker, 809 F.2d 187, 191 (2d Cir. 1987) (rejecting argument that 26 U.S.C. § 86 violates the Tenth Amendment). Plaintiff incorrectly relies on New York v. United States, 505 U.S. 144 (1992) for the proposition that the federal government's powers are limited, (Pl.'s Mem. of Law in Support of Mot. for Partial S.J. at 6), because 26 U.S.C. § 68 fits squarely within Congress' right to tax income.

Finally, the tax code provisions challenged here do not violate Article I, Section 8 of the Constitution which states that "all Duties, Imposts, and Excises shall be uniform throughout the United States." U.S. Const. Art. I § 8. Regarding the Uniformity Clause, the Supreme Court has concluded that:

> Congress cannot accommodate its legislation to the conflicting or dissimilar laws of the several states, nor control the diverse conditions to be found in the various states, which necessarily work unlike results from the enforcement of the same tax. *All that the Constitution (article I, § 8, cl. 1) requires is that the law shall be uniform*

> *in the sense that by its provisions the rule of liability shall be alike in all parts of the United States.*

Florida v.Mellon, 273 U.S. 1, 12 (1927) (rejecting contention that a federal inheritance tax is not uniform merely because some states impose inheritance tax while others do not) (emphasis added). Thus, plaintiff misses the mark when he claims that the challenged provision *in effect* applies unequally to residences of different states. As the Mellon court concluded, the Uniform Clause only protects against unequal application in the *provisions* of the law. On its face, 26 U.S.C. § 68 applies equally to residents of all states as it limits the itemized deductions that all taxpayers above a specific adjusted gross income can take.

Thus, the Court grants the government's motion to dismiss with respect to the claim regarding the constitutionality of 26 U.S.C. § 68.

III. 26 U.S.C. §§ 106 and 162(l) and 26 U.S.C. § 163(h)

Plaintiff claims that in providing for limitations on two deductions in the tax code -- one on what he can deduct for health insurance and another on what he can deduct after purchasing a home -- Congress unconstitutionally delegates its taxing power to private entities. (Wolstein Aff. Ex. A ¶¶ 21-33, 38-50.) Plaintiff's argument is essentially that since the decisions of private entities such as an employer

who decides who to hire or the bank who decides to whom to extend a mortgage, affect the operation of these provisions, there has been a delegation of powers in violation of the Due Process Clause.[1] The Court disagrees.

The Supreme Court has stated that the Due Process Clause of the Fifth and Fourteenth Amendments only limit Congress' taxing power in "rare and special instances." A. Magnavo Co. v. Hamilton, 292 U.S. 40, 44 (1934). The Due Process clause may only be applicable if a taxing statute is "so arbitrary as to compel the conclusion that it does not involve an exertion of the taxing power, but constitutes, in substance and effect, the direct exertion of a different and forbidden power ...." Id. Courts have dismissed the Due Process argument where the tax was reasonable and rationally related to the object of the tax and did not involve a fundamental right or a suspect class. E.g. Bryant v. Commissioner, 72 T.C. 757, 764 (1979) (upholding

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[1] In their papers, the parties dispute whether plaintiff is challenging procedural or substantive due process. It appears that one of plaintiff's arguments is that Congress delegated its taxing powers to private entities without sufficient standards. (Pl.'s Mem. of Law in Support of Mot. for Partial S.J. at 12.) Because the Court finds that there was no delegation at all, plaintiff's argument fails. The above analysis explains why a substantive due process claim is also without merit.

tax code provision allowing for a deduction for dependent care expenses paid to non-relative but not if paid to relative).

The challenged provisions do not implicate fundamental rights or a suspect class. They are reasonably related to their respective goals -- encouraging home ownership by allowing a deduction on interest payments arising from purchase debt and encouraging health insurance for employees. Thus, they do not fall into the "rare" category of provisions that may violate the due process clause.

Further, the Supreme Court has said that "[t]he propriety of a deduction does not turn upon general equitable considerations, such as a demonstration of effective economic and practical equivalence. Rather, it 'depends on legislative grace.' Commissioner v. National Alfalfa Dehydrating and Milling Co., 417 U.S. 134, 148-149 (1974) (quoting New Colonial Ice Co. v. Helvering, 292 U.S. 435, 440 (1934). Moreover, the Supreme Court has held that the taxpayer must accept the consequences of his choices and "may not enjoy the benefit of some other route he might have chosen to follow but did not." Id. Thus, because the plaintiff chose to purchase his home with cash and chose to become self-employed, he must live with the consequences of the federal tax code and the limitations it places upon him.

Plaintiff's argument that the provisions actually delegate tax power to private entities is not convincing. Nothing in the deduction provisions gives a private entity the power to tax or not to tax. Plaintiff relies heavily upon General Elec. Co. v. New York State Dep't of Labor, 936 F.2d 1448 (2d Cir. 1991), a decision involving a state wage statute that expressly left it to a labor organization and private actors to determine the rate of wages. The Second Circuit remanded the case to the district court for a possible finding that the statute was unconstitutional on its face and as applied. Id. at 1458-59. However, the provisions here are unlike the statute in General Electric because they do not, on their faces, delegate legislative power to private parties. Congress made a policy decision about who could take certain deductions. Nothing in the provisions delegates authority to private parties to do so. As a result, plaintiff's additional arguments that Congress did not provide for adequate standards for the private entities to follow, that Congress is evading accountability by delegating its authority, and that the delegations are unconstitutional per se, are moot because the Court does not believe Congress intended to delegate its powers at all.

Conclusion

In sum, the Court grants defendant's motion to dismiss and denies plaintiff's motion for summary judgment. The case is dismissed.

So ordered.

Dated: October 19, 2001
New York, New York

s/Lawrence M. McKenna
Lawrence M. McKenna
U.S.D.J.

Constitution of the United States

Article I, Section 8, Clause 1:

> The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;

Amendment X:

> The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Amendment XVI:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Title 26, United States Code

§ 68. Overall limitation on itemized deductions

(a) General rule. – In the case of an individual whose adjusted gross income exceeds the applicable amount, the amount of the itemized deductions otherwise allowable for the taxable year shall be reduced by the lesser of –

(1) 3 percent of the excess of adjusted gross income over the applicable amount, or

(2) 80 percent of the amount of the itemized deductions otherwise allowable for such taxable year.

(b) Applicable amount. –

(1) In general. – For purposes of this section, the term "applicable amount" means $100,000 ($50,000 in the case of a separate return by a married individual within the meaning of section 7703).

(2) Inflation adjustments. – In the case of any taxable year beginning in a calendar year after 1991, each dollar amount contained in paragraph (1) shall be increased by an amount equal to –

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the

taxable year begins, by substituting "calendar year 1990" for "calendar year 1992" in subparagraph (B) thereof.

(c) Exception for certain itemized deductions. – For purposes of this section, the term "itemized deductions" does not include –

(1) the deduction under section 213 (relating to medical, etc. expenses),

(2) any deduction for investment interest (as defined in section 163(d)), and

(3) the deduction under section 165(a) for casualty or theft losses described in paragraph (2) or (3) of section 165(c) or for losses described in section 165(d).

(d) Coordination with other limitations. – This section shall be applied after the application of any other limitation on the allowance of any itemized deduction.

(e) Exception for estates and trusts. – This section shall not apply to any estate or trust.